



FRED WILLIAMSON & ASSOCIATES, INC.
Telecommunications Management Services

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Ms. Donna A. Searcy, Secretary
Federal Communications Commission
1919 M Street N.W.
Washington, D.C. 20554

Dear Ms. Searcy:

Enclosed for filing are the original, and eleven (11) copies of the Comments of Fred Williamson & Associates, Inc. in Docket No. 92-133, Notice of Proposed Rulemaking and Order.

Copies are also being mailed to International Transcription Services, Inc.

Please acknowledge receipt of the enclosed by stamping and returning one copy of this letter in the enclosed self-addressed envelope.

Sincerely,

FRED WILLIAMSON & ASSOCIATES, INC.

Marc A. Stone
Manager - Regulatory/Legislative Affairs

MAS/bls

Enclosures

cc: I.T.S.

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FEDERAL COMMUNICATIONS COMMISSION

WASHINGTON, D.C. 20554

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

In the Matter of

Amendment of Parts 65 and 69 of
the Commission's Rules to Reform
the Interstate Rate of Return
Represcription and Enforcement
Processes

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CC Docket No. 92-133

SUBMISSION OF COMMENTS

on behalf of

Fred Williamson & Associates, Inc.

Submitted by:
Marc A. Stone
Manager - Regulatory/Legislative Affairs

Fred Williamson & Associates, Inc.
2921 East 91st Street, Suite 200
Tulsa, Oklahoma 74137-3300

September 10, 1992

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Executive Summary

FW&A agrees with the overall goals and intents outlined in the Commission's Notice, and the conclusion that there is no reason to begin a rate represcription proceeding on August 3, 1992. It serves the public interest to defer the filing of initial submissions until the Commission has satisfactorily completed this NPRM proceeding.

Further, we support represcription timing periods of at least three (3) years between represcriptions; but more importantly the proposal that future represcriptions should be based upon a showing of a need for represcription, rather than an arbitrary specific time frame. We believe it is extremely important to provide a period of stability and predictability of rate of return for those small Subset 3 LECs who remain under rate of return regulation of this Commission. This allows them to continue to invest in the nationwide telephone infrastructure network, as they clearly have demonstrated their willingness and intention to do so, to date. Any such future represcription should allow sufficient notice, so that planning cycles and implementation of infrastructure upgrades should not be displaced due to sudden and unexpected changes in the anticipated rate of return by LECs. Further, the extension of the minimum represcription period of three (3) years will better function in the current environment under which orders for new equipment, necessary for infrastructure network coordination can often take a year or more to be fulfilled. On this basis carriers should be afforded a reasonable period within which to expect to recover a reasonable rate of return for those investments dedicated to

the provision of interstate access service.

It is for these reasons, as well supporting the aim of regulatory simplification and reduced oversight, that FW&A commends the Commission for its issuance of this Notice; and supports those items in the Notice as specifically mentioned. We believe implementation of these proposals lead to regulatory simplification and reduction of the regulatory burden upon the small Subset 3 LECs.

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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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In the Matter of)
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Amendment of Parts 65 and 69 of)
the Commission's Rules to Reform)
the Interstate Rate of Return)
Represcription and Enforcement)
Processes)

CC Docket No. 92-133

COMMENTS OF
FRED WILLIAMSON & ASSOCIATES, INC.

Fred Williamson & Associates, Inc. (FW&A) is a telecommunications management consulting organization in Tulsa, Oklahoma; serving small investor-owned, rural, independent telephone companies located in Kansas, Oklahoma and Nebraska.

These Comments are filed in response to the Commission's Notice of Proposed Rule Making and Order (NPRM).

I. Introduction

This Notice proposes regulatory reform and reduction of regulatory burdens reflected in Part 65 Rules and in Part 69 Rules, related to the determination period and represcription of rate of return for local exchange carriers (LECs) who are regulated on a rate of return basis. The Commission invited Comment on their proposals to change: (1) How to begin the represcription proceedings; (2) How to conduct them; and (3) How to estimate the cost of capital during their

course.¹ FW&A essentially supports the majority of the Commission's proposals contained in this NPRM. Specifically, we applaud the Commission's proposed attempt for reduction of the regulatory burden on those LECs who remain under rate of return regulation; and believe that proposals in the NPRM will enhance the stability and predictability of revenues/earnings of the smaller LECs. This stability and predictability will enable them to continue their investments in the infrastructure enhancements and improvements so vital to the nationwide telecommunications network.

II. Periods of Represcription

FW&A supports the proposal that the "trigger" for initiating change to represcription proceedings would only occur at such times as market indicators, or other indicators, would warrant such changes.² We do not support the continuation of an automatic new represcription proceeding every two (2) years regardless of the conditions in the capital market. We believe that change of conditions is the greater indicator of need for represcription, and also that a period greater than two (2) years is required for earning stability; to allow continued encouragement for small LEC investment in infrastructure.

¹NPRM, CC Docket No. 92-133, adopted June 18, 1992, released July 14, 1992; paragraph 3

²Id., paragraph 4

III. End the "Paper Hearing" Process

FW&A supports the proposal to replace the "paper hearing", with a Notice and Comment system, and agrees with the Commission that such Notice and Comment would eliminate many of the unnecessary burdens of the current represcription process.³

IV. Cost of Capital Calculation⁴

It is in this area that FW&A finds itself somewhat concerned with current proposals, or with existing methodologies now utilized in the determination of rate of return to be applied for the smaller LECs. We continue to support the concept of no change in the policy of prescribing a unitary overall rate of return to be utilized in the Part 65 process.⁵ It is, however, in the determination of this unitary return that we find our concern. The smaller independent LECs (whom we represent and who make up the Subset 3 companies - less than \$40,000,000 in annual operating revenues) are by nature not public stock offering companies. Their stock, if traded, is done so, lightly and in non-public markets (not on the American Stock Exchange, New York Stock Exchange, etc.) and therefore, there are no public documents in support of investor expectation of "value"; or underlying value inherent of such stock. It is therefore, in our opinion, impossible to determine a return calculation based on small LEC-specific equity and

³Id., paragraph 5

⁴Id. paragraph 6

⁵Id., paragraph 18

debt components, such as currently are developed using the RBOC Methodology (developing Rate of Return (ROR) and Return on Equity (ROE)).

We further are concerned with the use of a weighted capital structure (equity/debt), since the calculation of debt percentage, or cost, in the smaller LEC is often contentious in many regulatory arenas.⁶ Many of these smaller Subset 3 companies might be judged to have deminimus, or negative, equity if one were to merely mathematically measure their current net rate base, minus debt, to arrive at a "calculated" regulatory equity component. This is clearly not a proper measurement, either in regulatory or financial terms, nor a method whose use fosters a financially viable small independent LEC infrastructure. Because of many existing lender policies relating to debt periods exceeding asset value life, and other market conditions causing early retirement of debt-funded rate base items, the net book value (stated in Part 32 Rules format) of the small Subset 3 LECs often does not, by itself, represent the underlying "value" of the assets; or of what has been "used and useful" dedicated to public utility usage. Other measures of financial return, such as TIER (Times Interest Expense Ratio) coverage, which is currently employed by several of the major lenders of debt to the smaller companies, often can yield a better financial analytical view of their financial viability, stability and (perhaps of correctness of earnings of the company), as well as its "value" for its shareholders.

Further, other measures, perhaps some non-quantitative, including a company's ability and willingness to continue to invest in the infrastructure of the telephone network, and to continue to provide new and enhanced services to its subscribers, are other tests that perhaps might better

⁶Id., paragraph 18

be employed as means to measure the return need of a small LEC. Therefore, because of these type problems, and other related concerns, FW&A believes that measures other than strictly ROE or ROR measurement of the Subset 3 companies, can be a better "judgement tool" for use in the represcription process.

We do agree that other measures such as long term United States Treasury Bonds; DCF (Discounted Cash Flow) cost of equity estimates of the Standard and Poor 400 and Regional Holding Companies, 100 large electric utilities, or other comparable publicly traded companies might well provide a better basis upon which to judge the need for represcription; and also to establish benchmarks for such represcription. Further, we agree that the possibility of tracking a single measure of capital cost; and to measure, over time, such changes, in a moving average, is a potentially viable basis upon which to warrant a represcription proceeding. We would, however, suggest that if such moving averages were to be utilized, periods in excess of two (2) years should be used to determine the period.⁷

V. Minimal Period Between Future Represcription Proceedings

FW&A believes that at a minimum a three (3) year period between future represcriptions should be given consideration, absent extraordinary circumstances; so that some assurance may be given within the small LEC budgeting process for planning capital recovery, infrastructure investment, and necessary changes in company operation to accommodate such represcription.⁸ Because

⁷Id., paragraph 22 and 23

⁸Id., paragraph 24

of the current process, especially where a majority of small companies are members of the National Exchange Carrier Association (NECA) pool, currently implemented changes in represcription and revenue recovery based on return level changes have had a lagging effect to achieving rate relief and earnings. These lag periods also affect the ability of a small LEC to react in a timely basis to change capital and operating budgets. FW&A therefore believes a minimum of a three (3) year period would better allow companies to adequately plan for changes, if any are determined, in the represcription process.

VI. Use of RHC Data in the Represcription Process

FW&A contends that the use of RHC data is not necessarily the most useful measure in the current/proposed represcription process, primarily because changes in price cap LECs, and their achieved rate of return, has caused small LECs to no longer face comparable "risk" in their provision of interstate access service.⁹ Beyond that, the large RHCs also all have other operations, as well as interstate access, which may either act either to smooth their earning capability, or which by themselves influence RHC equity price (one component of the return prescription process); this is not the case in the smaller LECs. Again, also as previously mentioned, the smaller LECs are by and large not publicly traded companies, which also impacts investor expectation, or lack thereof, in establishment of "classic" regulatory calculated equity return expectation levels.

⁹Id., paragraph 41

FW&A does not support the proposal that NECA should be the point of data gathering or processing for "cost", or return calculations with debt/equity component reporting. NECA has not collected this type information, nor do we believe it is necessary or proper to allow NECA to gather or process "return" information.¹⁰ Rather, we believe an industry-wide data gathering could be directly provided to the Commission, without the need of third party intervenors; if such data collection is deemed necessary.

VII. Requests for Individualized Rate of Returns

We support the continuation of the use of petitions for individualized treatment in those cases where a LEC believes its rate of return requires exceptional facts and circumstances that are not transitory, and that would justify individualized treatment for at least two (2) years¹¹ (or as suggested in these Comments by FW&A for three (3) years). We believe however that the use of the correct represetation level, based on some composite utilized for these Subset 3 LECs should reduce, or eliminate, the majority of such petitions. We do however believe that the rules should ensure the availability of such petition, for those cases in which its use is required by a specific LEC.

¹⁰Id., paragraph 41

¹¹Id., paragraph 43

VIII. Surrogates for LEC Interstate Access Service Rate of Return

FW&A supports the use of potential surrogates in the represcription process. We believe that investor regard for both RHCs, the S & P 400 and the 100 large electric utility evaluate risk, with appropriate adjustment, as potential surrogates for the interstate access service of the remaining rate of return LECs.¹² FW&A does not at this time suggest specifics for how such adjustment may be made for differences between these surrogates and the remaining small rate of return LECs.

FW&A does support the proposal for the elimination of cluster analysis.¹³

IX. Cost of Equity

It is in this area that FW&A again finds itself most concerned that any change from utilizing the RHCs as the basic method of determining represcription rate of return can yield a represcription that may not reflect "risk" of a two-way provided service. While DCF, both historical and classical, does provide a methodology for determining cost of capital, ie. equity; as previously stated the small Subset 3 LECs are normally without marketable stock.¹⁴ Therefore equity pricing is nearly impossible to develop. While we support the continued use of "classic DCF",

¹²Id., paragraph 48

¹³Id., paragraph 52

¹⁴Id., paragraphs 54 through 60

if and when utilized to develop surrogates (such as application to the S & P 400), we are deeply concerned how one could truly develop cost of equity for small Subset 3 non-publicly held stock LECs. If, however, classic DCF were continued to be utilized, we would support the range of reasonableness, defined by midpoint for a zone of reasonability of surrogates, applied for future repurchases. We would urge the Commission to incorporate this range into their rules, although we are still concerned about use of DCF data (if such is deemed appropriate) as an evaluation of cost of equity for the small companies.

Further, in assessing the cost of equity capital in a small company, the idea of floatation costs as an additive to companies that do not float additional stock is also not appropriate.¹⁵ In fact, for these Subset 3 LECs normally the only exchange or issuance of stock occurs either in a recapitalization, with a sale, or for generation passing of a company (or in the event of estate purposes).

X. Risk Premium

This entire area of "risk" is concerning to FW&A, in that such discussions always tend to revolve on whether the small Subset 3 LEC is less or more "at risk" than the large LEC or RHC. Since the services in question are interstate access, which clearly require an originating and terminating end to be used, we are of the opinion that "risk" is equal for both the originating and terminating company. Interstate access service is universal and unitary, and if anything the small LEC has more "risk" inherent in its provision of interstate access service than to the large LECs

¹⁵Id., paragraph 66

or RHCs. We realize however the specific discussion herein is for the use of "risk" as an additive, or subtractor, to risk-free investment, dealing with cost of equity.¹⁶ Again, as previously stated, since the small LEC normally is non-publicly traded, capital asset process model (CAPM) and similar tools are not necessarily indicative of investor "risk" expectations of these companies.¹⁷ Rather it is the perceived "risk" in the provision of providing this service, or combinations of all subscriber services, that are the inherent "risk" to the small LEC. We therefore support the continued use of the surrogate, such as the S & P 400, as the presumption of a range of reasonableness to determine authorized rate of return on Subset 3 LEC interstate access service.¹⁸ FW&A believes that should be tempered not only by "risk premium"; but also by a view of the true risk of providing the service.

XI. Cost of Debt

Since there is such a wide range of Subset 3 companies sources and vintage of debt, we continue to support the use of methodologies previously discussed, and those currently employed in calculating the cost of debt components; that is, the continuation of use of RHCs embedded cost of debt as a primary vehicle. We would however support the modification of this method of utilizing embedded cost of debt for the GAAP method, rather than the current calculation utilized in the rate prescription process.¹⁹ FW&A believes that the GAAP method, in which the

¹⁶Id., paragraph 68

¹⁷Id., paragraph 69

¹⁸Id., paragraphs 71 through 75

¹⁹Id., paragraph 79

interest rate for each instrument equals the actual cost of interest expense explicit in the debt transaction is known and measured, and remains constant over the term of the debt; is correct. We believe that the method in the current rules misstates the "actual cost of debt"; and that the interest method more accurately (under GAAP) states that cost. We therefore concur with the Commission in its conclusion to use the interest method/GAAP method for debt calculation.

Finally, the use of publicly available data on corporate debt would also provide a reasonable proxy for cost of short term debt for LEC interstate access services.²⁰ We believe that this would provide the Commission with sufficient modifiers, or indicators, regarding both the need or desirability of represcription, as well a valid range to calculate a cost of debt component in the represcription process.

XII. Cost of Preferred Stock and Capital Structure²¹

In both of these areas FW&A believes it is not appropriate to use Subset 3 LEC specific costs. These components, if used at all, are highly volatile, and in most cases little, if any, preferred stock has been issued. The continuation of current Part 65 rules is sufficient, absent any modification, for attempts at specific measurement Subset 3 LECs related to attempting to measure specific capital structures.

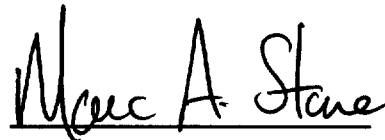
²⁰Id., paragraph 80

²¹Id., paragraphs 81 through 89

XIII. Miscellaneous Issues

FW&A supports the conclusion that represcription rules for interexchange carriers are not necessary at the current time, primarily given AT&T being under price cap.²² We also agree with the Commission's conclusion that cost of capital calculations need only be carried out to the second decimal place.²³

Respectfully submitted,

A handwritten signature in black ink, reading "Marc A. Stone". The signature is written in a cursive style with a horizontal line underneath the name.

Marc A. Stone

Manager - Regulatory\Legislative Affairs

²²Id., paragraph 90

²³Id., paragraph 92